

## **RUSSIA**

### **TRADE SUMMARY**

The United States registered a trade deficit of \$5.5 billion with Russia in 2000, an increase of \$1.5 billion from 1999. Russia was the United States' 39th largest export market in 2000. In 2000, U.S. exports to Russia were \$2.3 billion, a 25.7 percent increase from 1999. U.S. imports from Russia were \$7.8 billion in 2000, an increase of \$2 billion (34.3 percent) from 1999.

The stock of U.S. foreign direct investment in 2000 was \$509 million, a 23.5 percent increase from 1999.

### **OVERVIEW**

The U.S.-Russia Trade Agreement governs all trade relations between the United States and Russia. The USSR signed the agreement in June 1990, and it was approved by the U.S. Congress in November 1991. The agreement, however, never reached ratification during the existence of the USSR, and the United States offered the agreement (with minor technical changes) to each of the emerging states of the former Soviet Union. Russia's parliament approved the agreement, making it possible for the United States to extend Most-Favored-Nation (now Normal Trade Relations or NTR) status to Russia on June 17, 1992. Russia is in the process of negotiating terms of accession to the World Trade Organization (WTO). By the end of 2000, the Government of Russia had met eleven times with WTO members in working party meetings. Russia tabled its initial goods and services market access offers in February 1998 and October 1999, respectively. Russia presented a revised goods offer in June 2000, and after discussing its offers with Working Party members, it submitted revised goods and services offers in early 2001.

### **IMPORT POLICIES**

Frequent and unpredictable changes in Russian customs regulations and erratic customs enforcement have created problems for foreign and domestic trade and investment, and a burdensome import licensing regime including quotas for alcohol has depressed imports in that sector. However, the most significant factor affecting U.S. exports continues to be depressed purchasing power in Russia subsequent to the August 1998 financial crisis. The devaluation of the ruble put imports at a price disadvantage initially.

Imports remain at depressed levels since the August 1998 financial crisis. Despite real ruble appreciation of about 13 percent in 1999 and 11 percent in the first nine months of 2000, imports in dollar terms fell by over 30 percent in 1999 and have recovered by only 12 percent in the first nine months of 2000. Part of this decrease may reflect the weakness of the euro against both the dollar and the ruble, as most of Russia's trade is euro-denominated. However, it also reflects the trend towards increased market share of Russian companies at the expense of imports, particularly in the food processing and light manufacturing sectors. Real incomes, while rising, also remain below pre-crisis

levels. U.S. exports to Russia decreased by an even larger margin in 1999, and, although there was some recovery in the later months of 1999 which continued into 2000, exports remain well below pre-crisis levels. Many exporters remain cautious about entering the Russian market due to the reduced availability of trade financing and bad experiences with payment and clearance after the August 1998 financial crisis, although these problems became less common in 2000.

Since 1995, Russian import tariffs have generally ranged from five to thirty percent, with a trade-weighted average in the range of 11.5 to 15 percent. In addition, value-added taxes (VAT) are applied to virtually all imports, and excise taxes are applied to a small selection of goods. The VAT, which is applied to the price of the import plus its tariff, is currently 20 percent. Some food products and items for children (e.g., diapers) have a VAT rate of 10 percent. In 2000, the Russian Government approved a major revision of its tariff regime that took effect on January 1, 2001. Under this tariff unification, tariffs are consolidated into major product groups (raw materials, semi-finished goods, foodstuffs, finished products) with tariffs ranging from five to twenty percent for almost all tariff categories. This reform represents an overall decrease in tariff rates; the Russian Government states that average tariff rates will drop from 11.4 percent to 10.7 percent. However, in some cases the tariff unification will cause rates for individual items to rise. In addition, there will be some limited exceptions to the rate scheme, including higher rates for raw sugar (30 percent), and poultry meat and automobiles (both 25 percent). The Russian Government hopes that this unification will help combat customs fraud and improve customs collections. Import tariffs have declined in importance as a revenue source in recent years, but they remain significant -- they accounted for 5.9 percent of total government budget revenue in 2000.

Other Russian import tariffs that continue to stand out as particular hindrances to U.S. exports to Russia include those on autos, where combined tariffs and engine displacement-weighted excise duties can raise import prices of larger U.S.-made passenger cars and sport utility vehicles by over 70 percent. The Russian Government continues to have prohibitively high duties on imported aircraft (20 percent). Tariff waivers for purchase of foreign aircraft have been contingent on those airlines' purchases of Russian-made aircraft. In addition, Russian tariffs for U.S. wood product exports are at a level of 20 percent, compared with the preferential rate of 5 percent for tropical hardwood logs, lumber and veneer.

Throughout 2000, the government continued tight controls on alcohol production, including import restrictions, export duties, strip stamps and, again this year, increased excise taxes. Many of these controls are intended to increase budget revenues. Although the tariff unification lowered *ad valorem* duties on wine from 25 to 20 percent, other distilled spirits, with the exception of ethyl alcohol, remain under a specific duty of 2 euros per liter. Ethyl alcohol imports are assessed a tariff of 4 euros per liter. The *ad valorem* equivalent ranges from roughly 40 percent for bourbon to 200 percent for imported vodka.

Article 13 of the Federal Law adopted in January 1999 restricts imports of distilled spirits to no more than 10 percent of alcohol sales in Russia. Within this quota, not less than 60 percent of imports must contain 15 percent alcohol or less. Since most distilled

spirits, such as bourbon, rum and vodka contain 40 percent alcohol, this law effectively limits the import of distilled spirits to 4 percent of total sales in Russia. The Distilled Spirits Council of the United States estimates that U.S. distilled spirits exports to Russia have dropped from over \$31 million in 1995 to \$115,000 in 1999.

Import licenses are required for various goods, including ethyl alcohol and vodka; color TVs; sugar; combat and sporting weapons; self-defense articles; explosives; military and ciphering equipment; encryption software and related equipment; radioactive materials and waste including uranium, strong poisons and narcotics; raw and processed sugar; and precious metals, alloys and stones. Most import licenses are issued by the Russian Ministry of Economic Development and Trade or its regional branches, and controlled by the State Customs Committee. Import licenses for sporting weapons and self-defense articles are issued by the Ministry of Internal Affairs. With regard to import licenses for distilled spirits, Article 21 of the Federal Law adopted in January 1999 added the additional requirement that importers must have a minimum annual volume of 125,000 liters of distilled spirits in order to obtain a license. The Russian Government has drafted new legislation to simplify trade licensing procedures, which it plans to submit to the Parliament in 2001.

In September 1999, the State Customs Committee issued a decree restricting points of entry for poultry shipped to Russia from any country that does not have a direct land route to Russia. This decree was implemented in February 2000. Under the decree, poultry shipped from the United States and all countries without a land border with Russia must use one of 30 specified sea ports. The decree raises issues under the U.S.-Russia Trade Agreement, which calls for MFN treatment in customs activities.

The Ministry of Communications and Information's Order No. 8 mandates that certain types of switching equipment be manufactured only in Russia. This has motivated some U.S. telecommunications suppliers to set up manufacturing operations or joint ventures in Russia, rather than import the equipment.

#### **STANDARDS, TESTING, LABELING AND CERTIFICATION**

U.S. companies report that Russian standards and procedures for certifying imported products and equipment are non-transparent, expensive, time-consuming, and beset by redundancies. However, certain improvements can be noted in the process of standards setting and the repeal of onerous labeling requirements, which were actually repealed prior to their implementation. Russian regulatory bodies are reluctant to accept foreign testing centers' data or certificates. U.S. firms active in Russia have complained of limited opportunity to comment on proposed changes in standards or certification requirements before the changes are implemented. Occasional jurisdictional overlap and disputes between different regulatory bodies compound certification problems.

In recent years, there has been a substantial movement toward the adoption of the common international language on product standards and certification procedures and some improvements in practice. In 1998, the Russian government established an inquiry point for regulations covered by the Technical Barriers to Trade (TBT) Agreement in the World Trade Organization (WTO). On July 31, 1998, new

amendments to Russia's Law on Certification of Products and Services, (which Russia claims generally meet requirements of the TBT Agreement,) went into effect. The law allows a manufacturer to submit a declaration of conformity in the certification procedure for a limited number of products. The government has established a list of 200 products eligible for this procedure. Russian standards and certification bodies have been working closely with the U.S.-Russian Business Development Council, the local American Chamber of Commerce, and several U.S. government agencies to become acquainted with international practice in this area and the concerns of international companies. As a result, approximately 30 percent of 22,000 Russian standards now conform to international norms, and many sore points of the standards and certification process have been removed. Russian officials claim that the certification situation could be improved still further if the Duma would approve a pending bill to reduce the number of products to be certified and streamline the process. The government has included this law in its legislative work-plan for WTO accession.

Nevertheless, the current Russian product certification regime makes it difficult to get products into the Russian market and creates barriers to Russian exports as well. Manufacturers of telecommunications equipment, construction materials and equipment, and oil and gas equipment continue to report serious difficulties in obtaining product approvals. Certification is particularly costly and prolonged for telecommunications equipment, which is tested for compliance with standards established by both the State Standards Committee (Gosstandart) and the Ministry of Communications and Information. Interpretation of these standards can vary from region to region. The certification process can take as long as 12-18 months. After going through the lengthy certification process, product certification lasts for only three years, rather than for the life of the product. Self-certification in this area is currently not possible. Order 113, introduced by the Ministry of Communications' predecessor Gostelkom in July 1998, required all mobile communications systems in Russia to convert to the Russian GLONASS system by July 1999, instead of the U.S. Global Positioning System (GPS). This required costly reconfiguration of systems by U.S. telecommunications companies to maintain access to the Russian market, even though GLONASS is widely regarded as less reliable than GPS.

In April 2000, the Duma repealed previous requirements for holographic marks of conformity, which foreign businesses had complained were costly and unnecessary.

Requirements of the Russian Veterinary Department are burdensome and sometimes of questionable scientific or food safety value. As Russia looks to WTO accession, the Veterinary Department will need to develop a more transparent, science-based and WTO-consistent food inspection system. Biotech food products are likely to attract regulatory attention from Russian authorities in the coming year.

## **GOVERNMENT PROCUREMENT**

In the context of Russia's accession to the WTO, the United States has requested that Russia consider membership in the WTO Agreement on Government Procurement. The Russian government has virtually eliminated the Soviet practice of centralized imports through state-owned foreign trading companies. Some large-scale trade deals for state

needs still take place. Typically, however, the government awards the right to implement such deals on its behalf to private or quasi-private trading houses.

Russian ministries and government agencies are frequent purchasers of equipment, goods and services for their own needs or for the needs of various domestic organizations or groups (i.e., the military, regional health organizations, or population centers located in remote areas). In April 1997, the Government of Russia established procedures for public tenders for some government procurement. A government procurement bill, based on competitive bidding, is before the Duma, but the Duma did not take action on this bill in 2000. The Russian Government has a strong political bias toward supporting domestic industries. An example of such bias occurred in 1997 when government agencies were directed to use only domestic automobiles (a program which ran into problems and is currently not strictly enforced). Additionally, U.S. pharmaceuticals manufacturers have reported lack of transparency and discriminatory treatment of foreign companies in state tenders for pharmaceuticals purchases.

On January 13, 1999, an amendment to the Federal Law on Communications went into effect, which appears to vaguely exhort government agencies purchasing communications equipment in efforts to give priority to systems using Russian-produced equipment. This also has motivated some major U.S. suppliers to begin production in Russia.

### **EXPORT SUBSIDIES**

The Russian government's industrial policy guidelines emphasize export promotion and import substitution. In practice, there has been limited budgetary funding for such projects, and the programs that do exist are designed to provide support to industries which export, rather than targeted export subsidies. In addition, the state-owned railroad charges lower freight rates for certain exports (e.g., steel and cement). In December 1999, then-Acting President Putin proposed the establishment of a Russian export credit guarantee agency, but no action was taken to implement this proposal by the end of 2000. Russia has no explicit export subsidies on agricultural products, although it has suggested in WTO accession talks that it would like to reserve the option to use agricultural export subsidies in the future.

### **INTELLECTUAL PROPERTY RIGHTS PROTECTION**

According to industry sources, estimated losses to U.S. industry due to intellectual property piracy amounted to nearly \$1 billion in 2000. Video piracy, which soared in the wake of the financial crisis, has retreated somewhat as customers have more income to purchase legitimate products, and has benefitted from better enforcement. The motion picture industry believes video piracy in Moscow is now around 50 percent, down from around 80 percent after the 1998 crisis. Nonetheless, piracy in other regions remains extremely high.

With the exception of protection for pre-existing copyrighted works and sound recordings, the Russian government has made considerable progress in constructing a legal framework to bring Russia up to world standards in the area of intellectual property protection. Since 1992, Russia has enacted generally acceptable laws on trademarks, patents, protection of semiconductor chips, computer software, and copyrights. Russia is a party to the Paris Convention, the Universal Copyright Convention and other major multilateral intellectual property conventions. In 1995, Russia acceded to both the Berne Convention for the Protection of Literary and Artistic Works and the Geneva Phonograms Conventions. The U.S.-Russia bilateral trade agreement requires Russia to provide protection for intellectual property. Russia is also in the process of joining the WTO, and as a new member will be required to meet obligations under the WTO's Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS Agreement) immediately upon accession. The Russian Patent and Trademark Agency (Rospatent) has drafted amendments to existing IPR legislation that should bring Russia's legislation largely in line with TRIPS standards. This legislation is scheduled to be submitted to the parliament in early 2001.

There are some signs of improved anti-piracy actions by Russian law enforcement agencies including a number of raids by police, but overall enforcement of intellectual property rights remains inadequate. Enforcement actions remain dependent on proactive moves by rights holders to allege rights violations and then call for investigation by law enforcement agencies. Strengthened criminal penalties for IPR infringement went into effect January 1, 1997. But, while the Russian government has begun to pay more attention to enforcement and prosecution, there are still disappointingly few cases in which these penalties have been applied, although stiff prison sentences in a DVD piracy case in 2000 were a welcome sign. As the estimated losses attest, piracy of U.S. video cassettes, films, music recordings, books, and computer software is extensive in Russia. Some U.S. companies have had difficulty registering well-known marks, although proposed legislation should improve protection for well-known marks. U.S. and multinational companies continue to report counterfeiting as a serious problem, especially for consumer goods, suggesting that IPR problems in Russia extend beyond copyright protection to include trademark issues as well. Administrative and judicial review bodies are only beginning to become active in IPR protection, and the circle of police and judges with IPR expertise remains small but is expanding. The U.S. industry believes that at the prosecutorial and judicial levels, officials often do not consider copyright infringements to be serious offenses, compared to other crimes.

U.S. investors also consider the Russian court system to be ill-prepared to handle sophisticated patent cases. However, a higher patent chamber has been established at the Russian Patent and Trademark Agency which should bring greater expertise and efficiency to resolution of trademark and patent disputes.

## **SERVICES BARRIERS**

Discrimination against foreign providers of non-financial services are in many cases not the result of federal law, but can stem from abuse of power, sub-national regulations, and practices that may even violate Russian law. For example, a few foreign providers of services have sometimes noted discrimination in obtaining licenses from local

authorities and often end up paying a range of fees that domestic companies allegedly bypass via bribes.

The federal law on "Banks and Banking Activity of 1996" permits foreign banks to establish subsidiaries in Russia. The law allows the Central Bank to impose a ceiling on the total amount of foreign bank capital as a percentage of the total bank capital in Russia, which is currently set at 12 percent, although there is some question as to the legality of the 12 percent level due to the manner in which it was set. The Central Bank has indicated it does not want this limit to dissuade foreign banks from entry or capitalization. Currently the Central Bank estimates the capitalization of foreign banks at 8.7 percent. Since 1997 the Central Bank has required foreign banks to hold a minimum of ECU 10 million (about \$11.5 million) in capital and to fill at least 75 percent of its employee staff and 50 percent of its management board with Russian nationals. Heads of Russian offices in foreign banks are required to be proficient in the Russian language.

In the insurance sector, a new law took effect in October 1999 which implicitly allows majority foreign-owned insurance companies to operate in Russia for the first time, but restricts their total market capitalization and prohibits them from selling life insurance or obligatory types of insurance. The law contains a "grandfather clause," exempting the four foreign companies currently licensed in Russia from these restrictions. Insurance companies with a minority foreign participation (49 percent or less) are not subject to these restrictions.

New tax regulations went into effect January 13, 1999 that provide tax breaks to the Russian film industry. These regulations have been extended into 2001 until a new law reforming the profits tax is adopted. Contracts for production, printing and showing of Russian movies (which include the sale of copyrights) will be exempt from the 20 percent value added tax. To qualify as a Russian movie, a film must be produced and directed by Russian citizens/companies, have foreign investment of no more than 30 percent and use a crew made up of no more than 30 percent foreign nationals. Fifty percent of the budget must be spent in Russia, and the film must use the Russian language or another language spoken in the Russian Federation. Investments in film production, distribution, and the construction and refurbishment of movie theaters, will be exempt from the profit tax. The 2000 budget also allocated 264 million rubles (about \$12 million) for direct support to the film industry.

The Ministry of Communications is reviewing operations of competitive telecommunications operators, which in many cases have foreign investment. To create "a level playing field," the Minister of Communications may mandate "universal service" requirements.

Telecommunications providers in Russia continue to complain of the Russian Government's lack of transparency in licensing and have criticized the five-year term of the licenses, which they argue do not allow them sufficient time to recoup their investment. The Ministry of Communications, for example, did not issue a tender offer for a third GSM license in Moscow; Russian provider Svyazinvest's Central Telegraph received its GSM license without competition or public consultations. Moreover, the

Ministry of Communications announced on September 5, 2000 its intention to confiscate valuable frequency bands from two existing cellular providers for possible transfer to a new entrant. The Russian Minister of Communications, after receiving a wide range of comments, rescinded the order, offering instead to investigate opportunities to convert military frequencies to civilian use.

Central Bank regulation 721-U, effective December 31, 1999, requires that payments greater than \$10,000 for imported services must receive advance permission from the federal service for currency and export control (VEK). Although the VEK was formally abolished in 2000, regulation 721-U remains in effect and is being administered by the Finance Ministry. While intended to combat capital flight, this measure has the potential to delay any financial transaction.

## **INVESTMENT BARRIERS**

A Bilateral Investment Treaty (BIT) was signed between the United States and Russia in June 1992. The treaty was approved by the U.S. Senate in October of the same year, but it cannot enter into force until ratified by the Russian Duma. The Duma did not actively consider ratification of the BIT in 2000.

Despite the passage of a new foreign investment law in June 1999, Russian foreign investment regulations and notification requirements can be confusing and contradictory. The law on foreign investments provides that a single agency (still undesignated, although draft legislation on registration procedures has been developed by the government) will register foreign investments and that all branches of foreign firms must be registered. The law does codify the principles of national treatment for foreign investors, including the right to purchase securities, transfer property rights, protect rights in Russian courts, repatriate funds abroad after payment of duties and taxes, and receive compensation for nationalizations or illegal acts of Russian government bodies. However, the law goes on to state that federal law may provide for a number of exceptions, including, where necessary, for "the protection of the constitution, public morals and health, and the rights and lawful interest of other persons and the defense of the state." The potentially large number of exceptions thus gives considerable discretion to the Russian government. The law also provides a "grandfather clause" that existing "priority" foreign investment projects with foreign participation over 25 percent be protected from unforeseeable changes in the tax regime or new limitations on foreign investment. The law defines "priority" projects as projects with a foreign charter capital of over \$4.1 million and with a total investment of over \$41 million. However, lack of corresponding tax and customs regulations mean that any protection afforded investors by this clause is only potential. In addition, although the situation has improved over the past few years, foreigners encounter significant restrictions on ownership of real estate in some cities and regions in Russia.

Current Russian legislation restricts foreign investment in the aerospace industry to 25 percent of an enterprise. Foreign investments in the natural gas monopoly Gazprom are limited to 20 percent and in the electrical power giant Unified Energy Systems to 25 percent. However, these limits have not been strictly enforced and current foreign holdings in these two entities is believed to exceed these limits by a small amount.



Gazprom management in November 2000 proposed raising their investment limit to 40 percent, but the company's board failed to adopt the proposal. The Duma has before it draft legislation which would limit foreign participation in the tourism sector as well as a separate bill that would prohibit and/or allow restriction of foreign investment in a wide range of sectors in the economy, but failed to take any action on this legislation in 2000.

The "Law on State Regulation of Production and Distribution of Ethyl Alcohol and Alcohol Products," enacted by the Russian Duma on October 25, 1995, bans foreign investment in the importation, bottling and distribution of beverages containing more than 12 percent alcohol by volume. Under the law, any Russian company with foreign capital or investment is prohibited from engaging in these commercial activities. The law prevents U.S. companies seeking to invest in the domestic distilled spirits industry from doing so.

A major tax reform law that becomes effective January 1, 2001 should reduce tax-related investment barriers. It substantially amends the Value-Added Tax, Excise Taxes, Personal Income Tax and Unified Social Tax. These reforms will reduce the nominal tax burden from 41 percent of GDP (only 37 percent actually collected) to 39 percent in 2001. The Government of Russia says that it hopes to reduce the tax burden to 34 percent of GDP by January 2004. A Corporate Profits Tax reform bill is now pending in the State Duma.

Under the new law, Russia will become the first industrialized country to move to a flat income tax rate of only 13 percent for residents and 30 percent for non-residents. Six taxes were abolished entirely: the 1.5 percent social and housing turnover tax; the Employment Fund tax; the state border clearance fee; vehicle tax; vehicle acquisition tax; and oil and lubricant product sales tax. The Road Users turnover tax was reduced from 2.5 percent to 1 percent of turnover, and is to be abolished entirely in January 2003. However, overall profits tax rates rose, to 35 percent for general businesses and 43 percent for banks and financial institutions. Regions and municipalities received authority to grant exemptions to the regional portion of profits taxes. Some regions received specific regional exemptions, particularly Leningrad oblast. However, regions will no longer be able to grant individual tax exemptions.

Notable VAT tax changes in 2000 include VAT tax relief for small businesses; considerable clarification to deductibility rules; reduction of import VAT exemptions; and an attempt to provide a zero VAT tax on exports, although the VAT refund system still does not function well. Excise duties increased considerably on oil and gas from R5 to R66 per ton; gasoline duties will rise from R585 to R1850 per ton. Excise taxes on natural gas exported to CIS countries will fall from the current 30 percent to 15 percent. The new law expands the list of dutiable activities and objects, but several additional transactions became exempt, including exports performed by the producer of the goods (except oil).

Crime and corruption in commercial transactions and problems with the implementation of customs regulations also inhibit investment. The lack of rule of law for business opens the door for crime and corruption in commercial transactions. In addition, Russian trade and investment would benefit, for example, from improved dispute resolution

mechanisms, the systematic protection of minority stockholders rights, conversion to international accounting standards, and the adoption and adherence by companies to business codes of conduct. More transparent implementation of customs and taxation regulations is also necessary. Further, foreign-owned firms that adhere to legal obligations and international accounting standards are at a disadvantage in comparison to domestic firms, which routinely cancel inter-enterprise debts and maintain non-payment of external debts.

Adequate legislation and regulations (known as "normative acts") for Production Sharing Agreements (PSAs) are generally considered necessary for large-scale foreign investment in the Russian oil and gas sector. However, movement on an adequate PSA regime has been slow. Two U.S.-partnered projects, Sakhalin III and Northern Territories, were approved for PSA development by the Duma in 1999, while the Sakhalin II consortium, which included U.S. participation until mid-2000, began offshore production in mid-1999. After achieving some progress on foreign energy investment in early 1999 with the passage of production sharing legislation in the Duma following the 1998 passage of the Production Sharing Agreement Amendment Law itself, the Russian Government made relatively little progress in 2000.

There were, however, two significant developments with respect to PSAs in 2000. First, President Putin publicly endorsed the PSA concept, particularly with reference to Sakhalin projects, during a visit to Sakhalin in September. Second, later that fall, Putin gave responsibility for formulating and coordinating the government's own policy and actions on PSAs to the Minister of Economic Development and Trade German Gref. This action should help resolve some of the interagency conflicts that had slowed progress in the promulgation of "normative acts" necessary to implement an effective PSA regime. In fact, before Minister Gref assumed this responsibility, several normative acts had been adopted which were not acceptable to Western energy companies in their current form. By the end of the year, however, Minister Gref still had not arrived at a solution.

Harmonization of the newly passed tax code with PSA legislation is another issue which requires resolution before substantial foreign investment in Russia's energy sector can be expected. Regulations concerning environmental permits and pipeline access remain of concern to potential U.S. investors. Russian Central Bank restrictions on medium-term loans (more than 180 days) of hard currency for purchase of imported inputs have also presented an obstacle to foreign investment projects in Russia's energy sector. Existing PSA legislation retains a 70 percent local content requirement for equipment and requires 80 percent local labor content. There is no reference to the period in which these targets must be achieved, and U.S. companies believe they will be acceptable provided that subsequent regulations are written in an appropriately flexible way by the Russian government. A separate PSA amendment limits the total amount of foreign investment to 30 percent of Russia's "strategic" oil reserves. The precise meaning and import of this restriction remain unclear.

Russia has assumed obligations under Article VIII of the IMF Articles of Agreement to permit free payment of current transactions, but the Central Bank continues to maintain controls on capital flows. Such measures include requiring 75 percent of export

proceeds to be sold on the local market with repatriation in 7 days. Russia continues to maintain restrictions on profit repatriation with respect to investments in restructured Russian sovereign domestic debt.

Export tariffs imposed since 1999 by the Russian Federation are also of potential concern to some investors. These export tariffs have become a very significant revenue source for the Government of Russia, accounting for 16 percent of revenues in 2000. Export tariffs are levied on a range of goods, including oil, gas, forest products, ferrous and non-ferrous metals and scrap, hides and skins. Many export tariff rates were increased in 2000. In 2000, Russia's imposition of export tariffs on steel scrap caused trade frictions with the EU, which charged the tariffs violated its Partnership and Cooperation Agreement with Russia. The EU retaliated by cutting quotas on imports of Russian steel by 20 percent.

A Presidential Decree signed in early 1998 provides investment incentives for large investments in the auto industry that meet local content requirements. Although the decree is technically still in place, its implementation has been on hold since the onset of the economic crisis. In practice, U.S. investors in this sector have faced difficulty in obtaining relief promised by the Russian government from local content requirements and for special customs treatment.

## **AIRCRAFT**

Russian tariffs on imported aircraft were raised from 15 to 50 percent in March 1994, then were lowered to the still prohibitive level of 30 percent in 1995, and subsequently were lowered again to 20 percent in 1999. In 1996, the United States and Russia concluded a Joint Memorandum of Understanding (MOU) that addresses U.S. concerns about barriers to the Russian civil aircraft market and the application of international trade rules to the Russian aircraft sector. Under the MOU, U.S. aircraft manufacturers have been able to participate in the Russian market and share in its growth. The MOU also makes clear that the Russian aircraft industry will in time be fully integrated into the international economy. Russia pledged to undertake the same international trade principles as the United States and many others including becoming a signatory to the WTO Agreement on Trade in Civil Aircraft.

In the interim before Russia accepts its full international trade obligations, the MOU commits Russia to take steps, such as the granting of tariff waivers, to enable Russian airlines to meet their needs for non-Russian aircraft on a non-discriminatory basis. On July 7, 1998, the Russian Government issued Resolution 716 which requires Russian airlines to commit to the purchase or lease of Russian-made aircraft in order to receive duty reductions and exemptions for foreign aircraft acquisitions.

Current law stipulates preferential treatment (tax holidays, guarantees on investment) for Russian and foreign investors in aviation-related research and manufacturing ventures, but the Government of Russia is discussing a new concept of increasing state regulation in civil aviation, including in the areas of licensing, certification, and tariffs. With more than 70 percent of Russia's civil aviation fleet more than 10 years old and suffering from outmoded avionics and engines, Aeroflot and other Russian airlines are

seeking Western aircraft to replace old Soviet-built aircraft. It is expected that government policy will emphasize support and protection for domestic manufacturers and possibly promotion of mergers in the domestic aviation sector. To support leasing of aircraft manufactured domestically, the Russian Government is considering whether to provide government guarantees to support leasing projects, particularly for the domestically-produced Ilyushin-96 and Tupolev-204/214 aircraft. Russian law currently limits the share of foreign capital in aviation enterprises to less than 25 percent and requires that board members and senior management staff be Russian citizens.

## **ELECTRONIC COMMERCE**

Significant barriers exist in the area of electronic commerce. For example, Russian law does not currently provide identical legislative protection for both electronic and paper documents. Settlement issues need to be considered in conjunction with applicable currency control provisions. Registered trademarks are not recognized as entailing rights to the equivalent domain names, and the property rights that trademarks secure for their registered owners are currently not protected for the purposes of Internet advertising and commerce through web sites. Tax implications from electronic commerce are unclear.

President Putin, following the 2000 G-8 Okinawa Summit, directed the Government of Russia to draft a federal policy on use and development of the Internet in Russia. The document is due to be released by the end of the year. The Ministry of Communications and Information has announced a 2001-2006 draft program on e-commerce development and earmarked nearly \$2 million to implement it.

The Ministry of Communications and Information's top priority is a legal framework for e-commerce development, with business-to-business (B2B) and business-to-consumer (B2C) pilot projects and the opening of certification centers for hardware and software also targeted. The Ministry is circulating for interagency clearance a draft law "On Electronic Digital Signatures" needed to legalize the signing of contracts on the Internet. Early indications signal that the Ministry will likely define an electronic signature strictly, tying it to today's public key cryptography technology. At least two other e-commerce draft bills are headed for State Duma review, as interest in the parliament is rising.

The Supreme Court of the Russian Federation on September 25, 2000 struck down a provision of a Ministry of Communications order that requires certain communications service providers in Russia to install special eavesdropping equipment on behalf of the Federal Security Service (FSB). The intercept scheme, known as the System of Operative and Investigative Procedures (SORM), allows the Government of Russia to intercept voice and data, e.g., email transmissions, supposedly for reasons related to law enforcement. The ultimate impact of the court's ruling is still unclear, but for now operators will have to leave the installed intercept systems in place. The Ministry of Communications and Information and the FSB are weighing options.

